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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1944.

Number 713

PARKE, DAVIS AND COMPANY,
Appellant,

versus

J. EUGENE COOK, as Commissioner of the State Revenue Department,
Appellee.

Appeal from the Supreme Court of Georgia.

REPLY TO APPELLEE'S MOTION TO AFFIRM OR DISMISS.

B. D. MURPHY,
1130 Citizens and Southern National Bank Building,
Atlanta, 3, Georgia,

EDGAR WATKINS,
1207 Citizens and Southern National Bank Building,
Atlanta, 3, Georgia,
Attorneys for Appellant.

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STATEMENT OF THE CASE.

This case was brought in the Superior Court of Fulton County, Georgia, was determined on a general demurrer, and the decision of that Court was affirmed by the Supreme Court of the State of Georgia, which held that under the facts accepted as true on demurrer, appellant was subject to the tax involved in this proceeding.

All of appellant's contracts of sale are made in Baltimore, Maryland, from orders sent thereto by salesmen working under, and paid by, that office. All goods under such contracts are paid for by remittance to the Baltimore office.

Appellant is a large manufacturing corporation, selling its own manufactured goods. Its home office is Detroit, Michigan, and its principal sales office is in Baltimore, Maryland. It sells its goods throughout the United States and in foreign countries. For the purpose of lessening freight charges, appellant maintains a warehouse in Atlanta, Georgia, from which, on orders sent from the Baltimore sales office, shipments are made over rail carriers to the purchasers under the contracts made at Baltimore. These shipments from the Atlanta warehouse go, some to points in Georgia, and some to points in other states.

The Georgia statute under which the taxes here involved were assessed is copied with the Jurisdictional Statement heretofore filed **(Georgia Laws 1937, pages 109, 129; Georgia Code of 1933, Section 92-3113)**. This statute provides for a formula for determining the taxable proportion of the entire business income of a corporation doing business within and without the State by the use of three factors, which are described as (1) tangible property ratio, (2) manufacturing and cost ratio, and (3) sales ratio.

Appellant admittedly manufactures nothing in Georgia, and it alleges in its original petition in the trial court that no sales are made in Georgia. It has tangible property in Georgia on which it pays ad valorem taxes. The Georgia Income Tax Act of 1931, as amended **(Georgia Code, Secs. 92-3102, 92-3113)**, purports to tax foreign corporations only upon net income "from property owned or from business done in Georgia" on "sales made through or by offices, agencies or branches located in Georgia." The sales ratio factor in the statute is in this language:

"The ratio of the total sales made through or by offices, agencies or branches located in Georgia during the income year to the total net sales made everywhere during said income year."

For the year 1938, in making its return and in computing the tax due, appellant included as "Georgia sales" in the "sales ratio" factor of the apportionment formula, all goods shipped to purchasers in Georgia from the Atlanta warehouse. This resulted in a tax which appellant paid without complaint. The suit does not seek to recover this payment, because, as alleged by appellant, it had not at that time been advised by counsel of its legal rights. The Commissioner recomputed the tax by adding to "Georgia sales" in the "sales ratio" factor of the apportionment formula all goods shipped from the Atlanta warehouse to purchasers in other States. This resulted in an additional assessment of $1,337.63, which appellant paid under protest, and filed application for refund. For the year 1939, the Commissioner again assessed income taxes against appellant. Of the amount assessed, $1,763.42 was because of the inclusion as "Georgia sales" in the "sales ratio" factor of the apportionment formula shipments made from the Atlanta warehouse to purchasers within Georgia. This amount plaintiff paid under protest and applied for refund. The application was denied and the suit seeks to recover these amounts. A further assessment for 1939, $1,597.30, was made on account of the inclusion as "Georgia sales" in the "sales ratio" factor of shipments made from the Atlanta warehouse to purchasers in States other than Georgia. This much of the assessment has not been paid, and the suit seeks to have it canceled.

There is here involved two kinds of claims. One, that shipments, under the facts alleged, to points in Georgia, and the other, that shipments to points in States outside of

Georgia, cannot be considered or taxed under the Commerce Clause, and are arbitrary and unlawful under the due process and equal protection clauses of the Constitution of the United States.

ASSIGNMENTS OF ERROR.

The errors assigned in the Supreme Court of Georgia, and again relied on here, may be summarized:

The Supreme Court of Georgia erred in holding that the sales described in the petition of appellant as amended came within the meaning of the Georgia law of "sales made through or by offices, agencies or branches located in Georgia."

The Supreme Court of Georgia erred in not holding that the statute, Section 92-3113, as amended and applied, violated the Commerce Clause of the Constitution of the United States.

The Supreme Court of Georgia erred in not holding that said statute under which the tax was assessed against appellant, is void as so applied because violative of the due process and equal protection clauses of the Fourteenth Amendment of the Constitution of the United States.

THE FORMULA, AS APPLIED TO APPELLANT'S BUSINESS, IS ARBITRARY AND VOID.

It is recognized that a formula could be devised which would be free from arbitrariness. Such a formula, however, in order to be just and lawful, would have to divide the interstate and intrastate business by the use of factors found in both classes of business. Under the facts here, there are only three factors which are common to the business done in Georgia and the interstate business. These are: value of real property, value of personal property stored in warehouse, and wages paid.

Appellant owns real property in Atlanta. It stores some property in its warehouse in Atlanta, and it pays wages to its warehousemen in Atlanta. Similar real and personal property is also owned and wages paid in states other than Georgia. If these factors, common to both classes of business, were used, the formula would be the combined common factors in Georgia, described as x, and the combined common factors outside of Georgia, described as y, and the formula would be, as x is to y, so is the Georgia tax to the total net income.

Such a legal formula, however, was not used. Here the formula includes sales, none of which are made in Georgia, and is based upon interstate sales which do not fairly reflect net profits. The total sales used in the formula applied to appellants, if yielding any profit, which is not always true of sales, do not reflect profits derived from manufacturing, which is the chief business of appellant. Before appellant can be taxed under all the decisions, there must be a clear statutory authority therefor.

Ordinarily, as we recognize, the decision of a State court construing a State statute, is binding upon this Court. But, when such construction by the State Court attributes as a meaning of the State statute a rule in violation of the Constitution of the United States, a federal

question is involved, and it is respectfully submitted that the State court erred in holding that the statute applies here. A holding that it does apply presents a conclusion that makes the statute arbitrary and in violation of the Fourteenth Amendment to the Constitution of the United States.

The facts alleged in the petition necessarily follow the rules of pleading, and state ultimate facts. Details of the methods of doing business should be known in the determination of any constitutional question, and such determination should not ordinarily be had on a general demurrer.

GROSS INCOME IS AN IMPROPER FACTOR IN ARRIVING AT A DIVISION OF EARNINGS, INTERSTATE AND INTRASTATE.

The reason gross income is not used, and why its use has been so frequently condemned by this Court, is that gross income does not necessarily result in net income, nor is there any fixed relationship between gross and net income. The formula applied by the State is based on assumptions unsupported by any fact. It is assumed, in this formula, that no profits are made from manufacturing the articles sold, and that sales everywhere not only yield profits, but similar profits.

These unproved assumptions are contrary to experience, and make the application of the formula unfair and arbitrary. If there are profits from manufacturing, sales from one warehouse, disconnected from any manufacturing, should not be equalized with total sales which are of goods manufactured elsewhere.

NO SALES WERE MADE IN GEORGIA.

The Supreme Court of Georgia held that when a contract of sale was made outside of Georgia, and goods were shipped to a warehouse in Georgia from another State, and then delivered by the warehouse, on such contract of sale, to a resident of Georgia, the sale was made in Georgia. It also held that the same rule applied when a delivery was made to a State other than Georgia. These findings seem to be in principle contradictory, and the Court, we submit, erred in holding that the sales were made in Georgia.

For this holding, the Court cited: **Georgia Code, 1933, Section 96-107**; **Kehrer v. Stewart, 117 Ga. 969**; and **Mann v. Glauber, 96 Ga. 795.** Extensive discussion of these citations is unnecessary. It suffices to say that **Code Section 96-107** merely lays down a rule which, says the section, "the intention of the parties to a contract may dispense with." Here, the allegations show that the contract was not a Georgia contract.

The **Kehrer case**, also cited by the Court, we submit announces a rule in conflict with the Supreme Court's decision herein. In the **Kehrer case**, an occupation tax was involved. There was no question of any formula based upon relative sales. The Supreme Court in that case, at page 973 of its opinion, cited several cases, including **Stone v. State, 117 Ga. 292. Stone v. State** deals with a situation almost exactly similar to the one here. There, the Supreme Court said that the transaction showed that the party was engaged "in interstate commerce." After the case cited at page 973 of its opinion in the **Kehrer case**, the Court decided a principle which, if applied here, means that the Supreme Court was wrong in the instant case. The Supreme Court of Georgia there said:

> "Under these rulings, by which we are bound, that part of Nelson Morris & Company's business which

consisted in shipping goods to Atlanta to fill orders previously received, the goods being delivered in accordance with such orders, was interstate commerce. It was, therefore, not subject to taxation or interference by the State, and an act seeking to impose any tax upon such a business would be unconstitutional and void. The occupation of the plaintiff in error as agent for the conduct of this part of the business is so closely and directly connected therewith that, in so far as the tax act seeks to tax him as such agent, the act is void."

This Court affirmed the Supreme Court of Georgia in the **Kehrer case, 197 U. S. 60, 65.** This Court, in so affirming the Georgia Court, at page 65, showed the differences in the facts of that case and the instant case.

CASES RELATING TO THE USE OF GROSS INCOME AS A BASIS FOR DIVIDING INTRASTATE AND INTERSTATE EARNINGS.

This is a controlling issue in the instant case, and the question is discussed in the statement of jurisdiction filed herein. To that statement is attached the opinion of the Supreme Court of Georgia, which has not yet been reported, and the applicable statutory provisions. There is also cited the leading cases referring to gross income. These are: **Crew Levick Co. v. Pennsylvania, 245 U. S. 292; J. D. Adams Mfg. Co. v. Storen, 304 U. S. 307; Gwin, White & Prince v. Henneford, 305 U. S. 434.**

We also, in the statement of jurisdiction, cited other cases conflicting, as we submit, with the decision of the Supreme Court of Georgia in this case. Briefly, we shall now refer to the cases relied upon by the Supreme Court of Georgia in the decision in this case.

American Steel and Wire Company v. Speed, 192 U. S. 500: This case dealt with a merchants' tax, and is not ap-

plicable to a formula for distributing income between interstate and intrastate transactions. In the **Steel case**, the taxpayer held its property "in the state of sale." This property was "there held in store at the risk of the Steel Company, to be sold and delivered as contracts for the purchase were completely consummated." The merchants' tax there levied applied to all merchants in exactly the same way. There was no question about the taxpayer being a merchant. There is no resemblance between the principles there involved and the principles here involved.

In the concurring opinion of Mr. Justice White in **Pullman Company v. Kansas (1910), 210 U. S. 56, 64, seq.**, there is an elaborate discussion, applicable to the case here, and there is also a dissenting opinion by Mr. Justice Holmes. These opinions sufficiently distinguish the character of a case like the **Steel and Wire case** from this case.

The next case cited by the Supreme Court of Georgia in this case is **United States Glue Company v. Oak Creek, 247 U. S. 321.** In the **Oak Creek case**, this Court called attention to the fact that that case involved a domestic corporation (page 326). There, said the Court, at the same page, the tax was on the privilege of exercising a franchise, and "the amount is made dependent in fact upon the value of its property situated within the State." If, in the instant case, the tax had been made dependent upon the value of the taxpayer's property in Georgia, the amount of the tax would have been but a few dollars. In the **Oak Creek case**, the Court referred to and designated as "the correct line of distinction," the **Crew-Levick case**, above, and said that in that case this Court had held "that a state tax upon the business of selling goods in foreign commerce, measured by a certain percentage of the gross transactions in such commerce, was by its necessary effect

a tax upon the commerce . . ." (page 328). Further discussing the question of gross receipts, at **page 329**, the Court in the **Oak Creek case**, said:

> "A tax upon gross receipts affects each transaction in proportion to its magnitude, and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce."

The next case cited by the Supreme Court of Georgia is **Underwood Typewriter Company v. Chamberlain, 254 U. S. 113.** There this Court again cited the **Adams case**, above, called attention to the fact that the case under consideration involved a tax "based upon the net profits earned within the State," and said:

> "That a tax measured by net profits is valid, although these profits may have been derived in part, or indeed mainly, from interstate commerce, is settled."

The Court was there dealing with a property tax, or franchise tax (see page 120). There, at page 121, this Court held that the

> "method of apportionment * * * was meant to reach only the profits earned within the State."

Next, the Supreme Court of Georgia cited **International Harvester Company v. Wisconsin, May 15, 1944, ... U. S. ..., 88 L. ed. adv. pamp. 905.** Properly to appraise **International Harvester case**, the decision therein should be considered in connection with other cases decided the same day. See **McLeod v. Dilworth Company** and **General Trading Company v. Tax Commission.** These three cases, decided at the same time, and in which concurring and dissenting opinions were filed, discussed at length the

question of distributing a tax when the taxpayer is engaged both in interstate and intrastate business. It will be noticed that in the opinion of the Court in the **Harvester case**, the **Adams case** is again cited and followed. It will also be noticed that, contrary to the facts here, the Court found in the **Harvester case** that "both the agreement to sell and the delivery took place in Indiana." That "both buyer and seller were in Indiana and payments were made in Indiana"; that the tax there was not "an attempted tax on the gross profits of interstate sales by both the State of the buyer and the State of the seller."

In the **McLeod case**, the Court held that "a boundary line is none the worse for being narrow." The sale there was made similarly to the sales here. The sale there was in Tennessee; the sale here was in Maryland. The delivery there was in Arkansas, which sought to tax. The delivery here, as to part of the transactions, was in Georgia, which also seeks to tax. If Arkansas can tax under the circumstances, then every State in which a delivery is made of shipments from Georgia could likewise tax the transaction. What was said in the **McLeod case** applies here. Here (page 911, Advance Pamp.) the Court said:

> "* * * in this case the Tennessee seller was through selling in Tennessee. We would have to destroy both business and legal notions to deny that under these circumstances the sale—the transfer of ownership—was made in Tennessee. For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction."

This Court also said:

> "The very purpose of the Commerce Clause was to create an area of free trade among the several States. That clause vested the power of taxing a transaction forming an unbroken process of interstate commerce in the Congress, not in the States" (page 912).

The **General Trading Company case** dealt with a use tax, which is not the kind of tax here sought to be recovered. In dissenting, Mr. Justice Jackson said:

> "The transaction of sale is not taxed, and being clearly in interstate commerce, is not taxable."

In the instant case we seek a holding that the transaction of sale cannot be taxed because interstate commerce is not taxable.

In the **McLeod case**, in dissenting, Mr. Justice Rutledge refers to the **Adams case** above and cites **McGoldrick v. Berwind-White Coal Company (1940), 309 U. S. 33.** In the **Coal case** this Court again cites with approval the **Adams case**, and holds:

> "That a State tax upon the operations of interstate commerce, measured either by its volume or the gross receipts derived from it, has been held to infringe the Commerce Clause."

Appellee in his motion cites **Shaffer v. Carter, 252 U. S. 37, 57,** and **State Revenue Commission v. Edgar Brothers, 185 Ga. 216.** Neither of these cases was relied on by the Court below and neither conflicts with our contention here. The first of these refers to and approves the **Crew-Levick case**, on which we rely. The second deals with a statute different from the one here involved, and pages 217, 224 and 225 deal with mining in Georgia.

Appellee relies on **Gwin, White & Prince v. Henneford**, cited hereinabove. In this case the tax was held invalid because (see page 438) measured by the gross income. This Court said:

> "Both the compensation and the tax laid upon it are measured by the amount of the commerce—the number of boxes of fruit **transported from Washington to purchasers elsewhere**; so that the tax, though

nominally imposed upon appellant's activities in Washington, **by the very method of its measurement reaches the entire interstate commerce service** rendered both within and without the state and burdens the commerce in direct proportion to its volume." (Emphasis supplied.)

It is respectfully submitted that the Supreme Court of Georgia in the instant case failed to follow the decisions of this Court, and that the cause should be reversed and remanded.

B. D. MURPHY,

EDGAR WATKINS,
Attorneys for Appellant.

December 2, 1944.